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CONSUMER CREDIT COUNSELING SERVICE

Introducing the L3C

The Low-Profit Limited Liability Company (L3C) is a great new tool for businesses which can help grow Montana's economy and also provide opportunities for the social betterment of Montana's citizens.

There are many businesses and non-profits in our state whose primary mission is to serve a socially beneficial purpose (such as a food bank). Many such businesses and non-profits that serve the social good in our state struggle to stay financially solvent and successful from year to year. The L3C simply provides a new way for these businesses to organize themselves as a company. By becoming an L3C, these businesses will be better positioned to receive investments from non-profit foundations. This, in turn, will make these organizations more attractive to for-profit investors. Thus, a socially-beneficial business that is organized as an L3C will have a much better chance of staying financially secure and successful.

Introducing the L3C in the state of Montana will:

- Simplify compliance with IRS tax rules for foundations making program related investments
- Give foundations another method to invest in socially beneficial causes
- Encourage new business growth that can thrive in a market-driven economy
- Support existing businesses with a new investment structure
- Support socially beneficial causes without additional taxation

Northern Plains Initiative
Partnerships to expand sustainable rural communities

How the L3C Works

There are many ways in which a company can organize itself here in our state, such as a single proprietorship, a corporation, or a Limited Liability Company (LLC). An LLC is a type of company where the different members in the company are taxed separately for profit related to the LLC, and the financial risk, or liability, of investing in the LLC is spread out amongst the different members in proportion to their investment in the business.

The Low-Profit Limited Liability Company (L3C) is simply a new type of LLC, but is different from a regular LLC in two important ways. First, the L3C must be organized and operated to serve a charitable purpose. Second, the L3C's organizing documents must contain specific language that is designed to help non-profit foundations invest successfully in the company.

Foundations are required by federal law to distribute 5% of their net assets every year for charitable purposes. They can fulfill this requirement by making grants, which is typically done, but also may make Program Related Investments (PRIs). PRIs are investments made by foundations, often into for-profit ventures, to support a charitable project or activity. PRIs may involve high risk, low return, or both, but are made anyway because they are intended to achieve a socially beneficial purpose. Currently it can be difficult and expensive for foundations to make PRIs. Foundations often have to engage in costly discussions with the Internal Revenue Service (IRS) to prove that a proposed investment qualifies as a PRI. This makes PRIs relatively rare in the investment world.

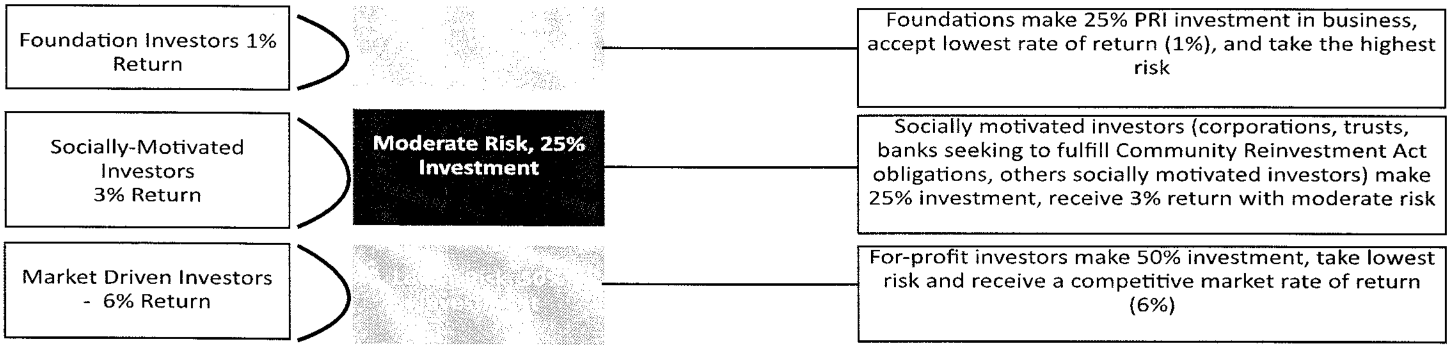
One very important thing the L3C accomplishes is to simplify the process of non-profit foundations making PRIs. The language in an L3C's operating agreement is required by law to mirror the IRS rules for qualifying as a PRI. This should facilitate a proposed investment in an L3C to qualify as a PRI and streamline the IRS approval process, saving the foundation great amounts of time and money.

Creating Successful Businesses

Besides helping foundations invest, what else does the L3C do? The greatest thing the L3C accomplishes is that it makes socially-beneficial business much more attractive to for-profit investors, opening them up to a wider range and greater volume of investment dollars. Organizing as an L3C can potentially make all the difference between being financially insecure and struggling to attract investor dollars from year to year, and being financially secure with adequate investment dollars.

When a socially-beneficial business is organized under L3C status, a foundation can invest in the business (with a PRI) at less than market rate and accept higher risk levels with their investment. This lowers the risk to other for-profit investors and increases the potential rate of return on their investments. An example of the investment structure of an L3C-status business is provided below:

"Layered Investment" Strategy



h, individuals, and families achieve economic independence.

With this type of investment strategy, the different types of members in the L3C stand to gain greatly:

- The foundation makes a Program Related Investment that is in line with its charitable mission, can potentially benefit the foundation's financial future, and attract far greater amounts of investment from for-profit investors.
- The for-profit investor can now invest successfully in the socially-beneficial business, because the L3C provides a competitive market rate of risk and return. With L3Cs, a whole new range of investment opportunities is opened up.
- The business is sustained with a varied, reliable array of investment sources, and is organized to serve a socially beneficial mission.

How Can the L3C be Used?

There are numerous ways in which the L3C can be used. A few are listed below:

- An L3C is set up to renovate an old building and provide low-cost rental space to start-up businesses. The L3C consists of two main members: a foundation interested in benefiting the community and a for-profit construction firm. Using the "layered investment" strategy, the foundation absorbs much of the risk and takes a small profit from the rented office space, the construction firm benefits from receiving most of the profits of the rented office space, and the community benefits with new, affordable business space.
- A factory in a small town with high poverty and limited employment options is about to close down due to insufficient rates of return for its investors (around 3% annually). An L3C is set up to save the factory. A foundation buys a large stake in the L3C, takes the greatest investment risk, and accepts no return or a small return on investment. The rest of the company's shares are sold off to for-profit investors who take a lower risk and are offered a higher return on their investment (now a desirable 6% return annually). As part of the L3C agreement, the foundation is granted 60% voting rights in the company, guaranteeing that the foundation will fulfill its social mission by making sure that the factory stays operational and stays in the small town. With a new stream of investors eager to invest in the factory and capitalize on higher rates of return, the financial future of the factory is far more secure.
- An organization that can be set up as an L3C in Montana is The Food Bank Network. The Food Bank Network wishes to continue its primary social mission of operating food banks, but also wishes to sell a small portion of its food products to a retailer, and use the profits to better sustain its non-profit mission. The L3C structure will allow The Food Bank Network to accomplish this.

Benefits to Montana

Creating the L3C in Montana simply means amending the existing Montana Limited Liability Company Act to allow for the creation of a Low-Profit Limited Liability Company. Allowing L3Cs to organize in Montana can potentially generate greater state tax revenue. L3Cs are taxed in the same way as LLCs: Incomes and expenses are divided amongst the members in the L3C, in proportion to their investments, and each members reports income earned from the L3C on its tax statement.

The L3C is an approved, legitimate form of business. The state of Vermont already has authorized the formation of L3Cs. In addition, the IRS ruled in December 2005 that a foundation's proposed investment in an LLC with L3C characteristics qualified as a PRI.

By authorizing the formation of L3Cs in the state, the benefits for Montana can be great. L3Cs can provide needed social benefit in difficult economic times without any additional burden on the state taxpayer. They offer a great number of opportunities for creating new businesses and sustaining existing ones. Most importantly, L3Cs can strengthen Montanans resolve to have a strong economy and have a great place to live, something that everyone can be proud of.

For more information and questions about the L3C please contact:

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